

GOOD LAW & ECONOMICS, BAD LAW & POLITICAL ECONOMY

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ABSTRACT

In recent years, a burgeoning literature under the intellectual umbrella of the “Law and Political Economy” (LPE) project has emerged, in response to an alleged disregard of the political and social embeddedness of both law and economics. The focus of our paper will be to render these assumptions explicit in order to argue twofold. First, whatever may seem “new” in LPE is an artifact of the LPE scholars and their conflation of what they refer to as “law and economics” with the “economic analysis of law.” Rather than incorporating an economic analysis of how markets *processes* work within a set of legal institutions (i.e. law and economics), they engage in a misplaced critique of an idealized market *outcome*, implying that markets are always efficient independent of the legal context within they operate (i.e. economic analysis of law). By failing to distinguish between these two analytical approaches, what is overlooked is that the same analytical starting point motivating the “new” LPE movement had been shared by an older tradition of “law and political economy” that took root in the Virginia School tradition of political economy. Secondly, by failing to understand this shared analytical starting point with the Virginia School, we regard the issues and criticisms of the LPE movement as a missed opportunity to diagnose the underlying causes of the social maladies they are highlighting. From a Virginia School standpoint, the very social maladies highlighted by the LPE movement are not caused by any inherent failures of market processes, but, rather ironically, a *consequence* of LPE scholars failing to embed market processes within a broader liberal market order.

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This “novel theory” is, of course, that the allocation of resources should be determined by the forces of the market than as a result of government decisions.¹ Quite apart from the malallocations which are the result of political pressures, an administrative agency which attempts to perform the function normally carried out by the pricing mechanism operates under two handicaps. First of all, it lacks the precise monetary measure of benefit and cost provided by the market. Second, it cannot, by the nature of things, be in possession of all the relevant information possessed by the managers of every business which uses or might use radio frequencies, to say nothing of the preferences of consumers for the various goods and services in the production of which radio frequencies could be used.

Ronald Coase²

I. INTRODUCTION

The years following the Great Depression, the Great Recession of 2008-2009 and, more recently, the social, economic, and political disruptions associated with the COVID-19 pandemic, have tested the case for a *liberal market order*.³ The phrase “liberal market order” used here is particularly important to emphasize the meaninglessness of analyzing the workings of a market economy in a political, legal, or social vacuum. However, a burgeoning literature under the intellectual umbrella of the “Law and Political Economy” (LPE) project has emerged, consisting mostly of legal scholars, but also economists, sociologists, political scientists, geographers, historians, and Indigenous and ethnic studies scholars, in response to an alleged disregard of the political and social embeddedness of both law *and* economics. The bifurcation of law and economics has led scholars of the LPE project to argue that the COVID-19 pandemic has brought into public consciousness a series of issues central to the LPE mission. These include greater income inequality, the neoliberalization of economic and social relationships (including the family), the exercise of monopoly power by platform economies and other corporations, systematic and institutionalized racism, climate change, political polarization and the rise of right-wing authoritarianism.⁴ Although it would be beyond the scope of any article to engage and reassess the claims

¹ The novel theory refers to that of Adam Smith. John D. Bishop, *Adam Smith's Invisible Hand Argument*, 14 J. BUS. ETHICS 165, 168 (1995).

² R. H. Coase, *The Federal Communications Commission*, 2 J.L. & ECON. 1, 18 (1959).

³ On the alleged challenges and existential threats to liberalism, and the robustness of a liberal market order, see Peter Boettke, *Liberalism Tested: 'Actions Prejudicial to the Interests of Others'*, 19 GEO. J.L. & PUB. POL'Y 675, 675 (2021).

⁴ Angela P. Harris & Jay Varellas, *Introduction: Law and Political Economy in a Time of Accelerating Crises*, 1 J.L. & POL. ECON. 1, 1 (2020).

made by LPE scholars, regarding these concrete issues, directly and in an empirical manner, it is important to note that all of the empirical claims made by LPE scholars are premised on an implicit set of *theoretical*, though misleading, assumptions.

The focus of our paper will be to render these assumptions explicit in order to argue twofold. First, whatever may seem “new” in LPE is an artifact of LPE scholars’ own creation due to their conflation of two related, though distinct approaches to legal theorizing: “law and economics” advanced by Ronald Coase and the “economic analysis of law” developed by Richard Posner. Rather than reincorporating an economic analysis of how markets *processes* work within a set of legal institutions (i.e. Coasean law and economics), LPE scholars engage in a misplaced critique of an idealized “market” *outcome*. By conflating these two analytical approaches, scholars of the LPE project incorrectly argue that law and economics scholars assume that markets are always efficient (or approximate efficiency), independent of the legal context within which they operate (i.e. Posnerian economic analysis of law). By failing to distinguish between these two analytical approaches, what is overlooked is that the same analytical starting point motivating the “new” LPE movement had been shared by an older tradition of “law and political economy” that took root in the Virginia School tradition of political economy. Secondly, by failing to understand this shared analytical starting point with the Virginia School, we regard the issues and criticisms of the LPE movement as a missed opportunity to diagnose the underlying causes of the social maladies they are highlighting. From a Virginia School standpoint, the very social maladies highlighted by the LPE movement are not caused by any inherent failures of market processes to achieve ideal efficiency, but, rather ironically, a *consequence* of LPE scholars failing to embed market processes within a broader liberal market order.

This paper proceeds as follows. In Section 2, we provide an overview of the LPE project and its core arguments. We ground our overview in the failure of LPE scholars to distinguish between theorizing in terms of “law and economics” and an “economic analysis of law,” as well as the policy implications of failing to disentangle the subtle distinction between these two analytic approaches to legal and economic theorizing.⁵ In doing so, we point out not only that what may seem “new” in LPE is not only a misplaced critique of theorizing about market processes as well as political processes, but also, in the words of Fred McChesney, “old wine in irrelevant new bottles.”⁶

⁵ R. H. Coase, *Law and Economics and A. W. Brian Simpson*, 25 J. LEGAL STUD. 103, 103-04 (1996); Alain Marciano, *Value and Exchange in Law and Economics: Buchanan versus Posner*, 20 REV. AUSTRIAN ECON., no. 2-3, 2007, at 187; Sophie Harnay & Alain Marciano, *Posner, Economics, and the Law: From “Law and Economics” to an Economic Analysis of Law*, 31 J. HIST. ECON. THOUGHT., no. 2, 2009, at 215.

⁶ Fred S. McChesney, *Behavioral Economics: Old Wine in Irrelevant New Bottles*, 21 SUP. CT. ECON. REV. 43, 43 (2013). To be clear, McChesney used this phrase in the context of behavioral critiques of standard economic theory.

Section III provides an analysis of the contribution of the Virginia School of political economy and its relationship to a particular tradition of law and economics that Todd Zywicki has dubbed a “George Mason School of Law and Economics”, which we will refer to here as the Virginia School of Law and economics that traces its origins back to Ronald Coase.⁷ By misdirecting their critique toward “law and economics” rather than at an “economic analysis of law,” LPE scholars fail to recognize how scholars of the Virginia School had engaged in the very same critique not only of the practice of economic science devoid of legal and political embeddedness, but also on the overemphasis of an efficiency criterion in the economic analysis of law. In spite of the shared analytical starting points of LPE and Virginia School scholars, where they diverge is in terms of the policy implications of their analysis. The failures of the market that LPE identify, for the Virginia School political economist, are an ironic failure to identify the necessary political and legal prerequisites for markets to exist in the first place.⁸ Section IV concludes with a summary and the implications of our argument.

II. THE LPE PROJECT: A MOVEMENT AGAINST LAW AND ECONOMICS OR THE ECONOMIC ANALYSIS OF LAW?

The LPE project refers to an intellectual movement that began in 2017, housed at Yale Law School. Its own description of the movement and its objectives are found on its webpage:

“Our work is rooted in the insight that politics and the economy cannot be separated and that both are constructed in essential respects by law. We believe that developments over the last several decades in legal scholarship and policy helped to facilitate rising inequality and precarity, political alienation, the entrenchment of racial hierarchies and intersectional exploitation, and ecological and social catastrophe. We aim to help reverse these trends by supporting scholarly work that maps where we have gone wrong, and that develops ideas and proposals to democratize our political economy and build a more just, equal, and sustainable future.”⁹

In 2020, the University of California, Berkeley, launched a journal for this emerging field, *Journal of Law and Political Economy*, the introductory article of which describes the LPE project as being grounded in “two central claims at the heart of Law and Political Economy.” First, “*law is central to the creation and maintenance of structural inequalities in the state and the market,*” and secondly, “*‘class’ power is inextricably connected to the*

⁷ Todd J. Zywicki, *Is There a George Mason School of Law and Economics*, 10 J.L. ECON. & POL'Y 543, 543-45, 549 (2014).

⁸ See also ISRAEL KIRZNER, *THE DRIVING FORCE OF THE MARKET* 77-87 (2000); ISRAEL KIRZNER, *DISCOVERY AND THE CAPITALIST PROCESS* 119-149 (1978).

⁹ About Page, LAW AND POLITICAL ECONOMY PROJECT, <https://lpeproject.org/about/> (last visited Oct. 4, 2024).

*development of racial and gender hierarchies, as well as to other systems of unequal power and privilege*¹⁰

The theoretical framework grounding the empirical claims of the LPE project is referred to as the “Twentieth-Century Synthesis,” which rests on two interrelated developments, the first of which we will address in this section, and the second of which we address in the following section of the paper.¹¹ According to their account, this “Twentieth-Century Synthesis” had begun in the 1970s as a coalescence of a “new division of labor in legal thought”¹² First, “the rise of law and economics centered efficiency and sidelined questions of distribution, power, and democracy. Second, in fields understood as more ‘political’—fields including constitutional law, for example—a parallel set of moves worked to render economic power hard to find and correct. . . .”¹³ Taken together, these intellectual developments are united by what LPE scholars regard as *a justification of the status quo in both markets and politics according to a principle of laissez-faire*, the result of which has been a theoretical vacuum providing “no framework for thinking systematically about the interrelationships between political and economic power” and “no means to analyze, let alone counter, contemporary concentrations of wealth and power, except insofar as they interfere with overall efficiency.”¹⁴

Our point here in raising the empirical claims of the LPE Project has not been to directly address them nor to dismiss them unilaterally, *per se*. Rather, our motivation in raising these claims is more fundamental: by rendering explicit the underlying set of premises upon which the theoretical framework of LPE (i.e. “The Twentieth-Century Synthesis”) is based, we argue that the LPE project is grounded in a fundamental misunderstanding of the very culprit they claim to be the source of the social maladies they wish to address. Therefore, rather than offer a transcendent critique that dismisses the problems that the LPE project has identified, for the sake of argument, we take the social maladies they identify as given. In this respect, our contribution is quite similar to that made by legal scholar Justin Hurwitz, who is critical of the LPE project, but does not criticize the LPE project “for the sake of criticism.” Rather, he argues that LPE and law & economics “are better read together than apart.”¹⁵ However, what the scholars of the LPE project, as well as Hurwitz, do not make explicit is a subtle, though fundamentally important, distinction between “law and economics” and “the economic analysis of law.”¹⁶ The conflation between the two, as we explain below, not only overlooks important differences between the two traditions of legal thought, but

¹⁰ Harris & Varellas, *supra* note 4, at 10.

¹¹ See generally, Jedediah Britton-Purdy, et al., *Building a Law-And-Political-Economy Framework: Beyond the Twentieth-Century Synthesis*, 129 YALE L.J. 1784 (2020).

¹² *Id.* at 1794.

¹³ *Id.*

¹⁴ *Id.* at 1790.

¹⁵ Justin Hurwitz, *What Is a Law and Political Economy Movement without Law and Economics or Political Economy?*, 17 J.L. ECON. & POL'Y 773, 774 (2022).

¹⁶ *Id.* at 775.

also generates fundamental misunderstandings of both law and economics and the economic analysis of law that undermine the LPE movement's own objectives. To the extent that LPE scholars have identified a set of social maladies that require addressing, by framing these problems in terms of an economic analysis of law, they are offering solutions that exacerbate the very social maladies they wish to ameliorate.

According to Purdy, Grewal, Kapczynski, and Rahman, their own definition of "law and economics," the timing of its rise, and their claim about its *institutional* origin is important for deconstructing the distinction between "law and economics" and "the economic analysis of law" *from their own standpoint*.¹⁷ "Modern" law and economics, as they define it, refers to "an intellectual enterprise that approached law using the tools of neoclassical economics."¹⁸ However, in a footnote to this definition, they allude to a "first law-and-economics movement" that "operated quite differently than the law and economic of the 1970s and 1980s" without explaining further.¹⁹

The interpretations (and misinterpretations) of Ronald Coase's seminal contribution to the origins of the law and economics tradition, "The Problem of Social Cost"²⁰, have required Coase and others to explain the distinction we are invoking here. "Law and economics consists of two parts which are quite separate although there is a considerable overlap. The first consists of using the economists' approach and concepts to analyze the working of the legal system, often called *the economic analysis of law*," in which "lawyers now have a predominant role."²¹ As Harnay and Marciano, elaborate on this point, Coase is praised for having founded the 'new law and economics' by delineating an economic analysis of law, but the expression *economic analysis of law* "was only coined much later by [Richard] Posner when he published his classic *Economic Analysis of Law* in 1973."²² Thus, when scholars of the LPE project are referring to "law and economics," they are neglecting to emphasize that their critique is directed toward a particular subset, the economic analysis of law, which is only part of a broader intellectual tradition. However, by not fully acknowledging this distinction, LPE scholars, unbeknownst to them it would seem, *by implication*, are critiquing an intellectual tradition that shares strong affinities with its own, both in terms of its analytical point of departure and its intellectual motivations.

This brings us to the pre-Posnerian tradition of law and economics, which shares much overlap with the LPE project. According to Ronald Coase, "law and economics is a study of the influence of the legal system on

¹⁷ See generally, *Id.*

¹⁸ *Id.* at 1795.

¹⁹ *Id.* at 1795 n.34.

²⁰ Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

²¹ Ronald H. Coase, *Law and Economics and A. W. Brian Simpson*, 25 J. LEGAL STUD. 103, 103-04 (1996) (emphasis added).

²² Sophia Harnay and Alain Marciano, *Posner, Economics and the Law: From 'Law and Economics' to An Economic Analysis of Law*, 31 J. HIST. ECON. THOUGHT 215, 216 (2009).

the working of the economic system. *It is the part of law and economics in which I am most interested.*²³ In spite of the fact LPE scholars identify Coase negatively with the economic analysis of law, Coase was explicit in differentiating between these two analytical approaches to legal theorizing. “Notwithstanding the many references to my work in the literature on the economic analysis of law,” Coase states, “*I have never attempted to contribute to it.*”²⁴ As we will argue in the next section, Coase is best understood as a part of the Virginia School of political economy *and* law and economics, an unidentified forerunner to LPE *before* the LPE movement.

The distinction between law and economics and the economic analysis of law can best be understood in terms of the analytical role that efficiency plays in economic and legal theorizing. Efficiency is based on a universal fact that, when faced by a set of alternative opportunities constrained by scarcity, individuals will choose the alternative that gives them more rather than less satisfaction in manner that maximizes the gains from trade. This is the basis of what F.A. Hayek refers to as “the logic of choice.” In other words, if individuals are rational and therefore maximize utility, then individuals not only continuously strive to maximize all the gains from trade and innovation, but also succeed in minimizing waste and error, subject to the constraints they face. The condition of Pareto optimality describes an outcome, or state of affairs, in which the well-being of one individual cannot be improved without hurting another. In other words, no reallocation of resources can result in an overall benefit to the group, and is therefore “efficient.” Conversely, when the condition of Pareto optimality is not met, a reallocation of resources can create a Pareto improvement that can benefit at least one individual without hurting another – or even, in principle, may improve the well-being of all. It follows that, when constraints change, individuals will make adjustments until no further improvements are possible.

The fundamental difference, therefore, between pre-Posnerian “law and economics” and “the economic analysis of law” can be understood as follows. In law and economics, Pareto-optimality is a *tendency generated as by-product* of a legal framework that *emerges* as a set of expectations accumulated by legal precedent. Therefore, the concept of “efficiency” is *institutionally contingent*, one in which marginal benefits and marginal costs are defined in the process of exchange between individuals.²⁵ The logic of choice is a necessary, though not a sufficient condition, in the sense that law emerges from judicial choice, but not from judicial design, and therefore law and

²³ Ronald H. Coase, *Law and Economics and A. W. Brian Simpson*, 25 J. LEGAL STUD. 103, 104 (1996) (emphasis added).

²⁴ *Id.* at 105.

²⁵ Mario J. Rizzo, *Law amid Flux*, 9 J. LEGAL STUD. 291, 311 (1980); *See also*, Alain Marciano and Elias L. Khalil, *Optimization, path dependence and the law: Can judges promote efficiency?*, 32 INT’L REV. L. & ECON. 72 (2012).

economics is not “a form of planning” as scholars of the LPE project would suggest.²⁶

In the economic analysis of law, Pareto optimality is adopted as an *ex-ante* assumption, or a first approximation, as a *state of affairs* governing human behavior and the relations of human beings to one another, not only in market settings but also in non-market (i.e., political) settings. This particular approach, adopted by Richard Posner from Gary Becker, later came to define the New Chicago School, which Melvin Reder refers to as the Chicago “Tight Prior Equilibrium.”²⁷ The logic of choice, in the economic analysis of law, is a sufficient condition for evaluating judicial decision-making according to an efficiency criterion. Rather than efficiency emerging *as by-product* of defining expectations based on legal precedent, judges, in this sense, make decisions based on an intent to generate an efficient outcome *as if* knowledge about marginal benefits and marginal costs are available as information outside of the legal context in which they are generated.

Our point in making this distinction is not meant to disparage a Posnerian economic analysis of law. Rather, it is to suggest to LPE scholars that by treating the rise of law and economics as simply an ideological conclusion in search of justificatory premises, as well as failing to draw a *methodological* distinction between a Coasean approach to law-and-economics and a Posnerian approach to the economic analysis of law, LPE scholars have failed to recognize that the application of neoclassical economics to legal analysis, ironically, has in fact *supported* the very policy conclusions that they wish to adopt, and therefore, LPE and the economic analysis of law share far more in common, methodologically speaking, than LPE scholars do with the Coasean law and economics tradition that preceded it.

To place this theoretical distinction between law and economics and the economic analysis of law in more concrete, policy-relevant terms, consider the case of monopoly power and anti-trust laws, particular as it pertains to the rise of platform economies.²⁸ LPE scholars claim that neoclassical economics, and the efficiency criterion it justifies, has delegitimized the use of anti-trust and legitimized the rise of monopoly power in the marketplace. Although, indeed, in the period in which LPE scholars describing Chicago economists had adopted a consumer welfare standard as an efficiency criterion to evaluate anti-trust policy and soften its enforcement, they have neglected to realize that neoclassical economics “provides critics of the market economy with the intellectual ammunition they need to press their attacks on the efficiency of capitalism. They merely need to tick off the respects in which real-world capitalism departs from the requirements for perfectly

²⁶ Purdy, Grewal, Kapczynski, and Rahman, *Building a Law and Political Economy Framework: Beyond the Twentieth-Century Synthesis*, 129 YALE L. J. 1784, 1799 (2020); See also, Peter Aranson, *The Common Law as Central Economic Planning*, 3 CONST. POL. ECON. 289, 294 (1992).

²⁷ Melvin W. Reder, *Chicago Economics: Permanence and Change*, 20 J. ECON. LITERATURE 1, 11 (1982).

²⁸ See, Lina Khan, *Amazon's Antitrust Paradox*, 126 YALE L.J. 710, 719-20 (2017).

competitive optimality.”²⁹ From an economic analysis of law standpoint, an efficiency criterion could theoretically be utilized to justify *both* the use of anti-trust, and refraining from its use, in the name of promoting a “competitive” wealth-maximizing outcome. On the one hand, anti-trust has been justified by Chicago School economists in the name of “efficiency” by enforcing the conditions of perfect competition and eliminating the deadweight losses associated with a monopoly price.³⁰ On the other hand, the use of anti-trust could be deemed inefficient if, in the process of intervening into the pricing or structure of an industry, the wealth dissipated from the expenditure of monopoly profits by firms to thwart such government intervention (i.e. rent-seeking) exceeds the efficiency gains that could be realized from a perfectly competitive price. The point here is that an efficiency criterion is not as clear-cut a justification of laissez-faire as LPE scholars would like to conclude, particularly if “laissez-faire” here means the outright abolition of antitrust regulation. A Posnerian approach to the economic analysis of law would not call for the complete repeal of anti-trust law, but simply to fine tune its application in a more “efficient” manner. As Posner states this point, since “efficiency is an important, although not the only, social value, this conclusion establishes a prima facie case for having an antitrust policy.”³¹

A law-and-economics approach, however, illustrates the redundancy of a consumer welfare standard of efficiency that is *consistent* with the objectives of the LPE project of eliminating concentrations of economic and political power. Consider the following statement by Lina Khan in her now well-known article, “Amazon’s Antitrust Paradox”, which LPE scholars have used to support their rejection of a consumer welfare standard as a criterion of efficiency: “My argument is that gauging real competition in the twenty-first century marketplace—especially in the case of online platforms—requires analyzing the underlying structure and dynamics of markets. *Rather than pegging competition to a narrow set of outcomes, this approach would examine the competitive process itself.*”³² Khan takes real-world market processes to be “imperfect.” But “imperfect” markets do not imply they are “flawed”, “suboptimal” or “non-ideal” compared to perfect competition, and therefore not necessarily justifying anti-trust policy against monopoly power as she would suggest. Rather, from a law-and-economics standpoint, indeed markets are “imperfect” but understood with an appropriate meaning of the term, meaning “incomplete” or not “thoroughly done.” Market “imperfections” that deviate from the textbook ideal of perfectly competitive equilibrium do not necessarily prevent the price system from coordinating economic

²⁹ Israel Kirzner, *How Markets Work: Disequilibrium, Entrepreneurship & Discovery*, 29 INST. ECON. AFF., (1997).

³⁰ Fred S. McChesney, *Be True to Your School: Chicago’s Contradictory Views on Antitrust and Regulation*, in THE CAUSES AND CONSEQUENCES OF CONSEQUENCES OF ANTITRUST: THE PUBLIC-CHOICE PERSPECTIVE 323, 325, 329 (Fred S. McChesney & William F. Shughart II, eds., 1995).

³¹ Richard A. Posner, *Antitrust Law: An Economic Perspective*, 4 (1976).

³² Lina Khan, *Amazon’s Antitrust Paradox*, 126 YALE L.J. 710, 717 (2017) (emphasis added).

activity, but in fact *depend on it*, since such deviations from the ideal require legal arrangements that incentivize the discovery of entrepreneurial profit opportunities that fuel tendencies towards equilibrium.³³

The relevant inquiry, then, is not whether government intervention is necessary to correct for market imperfections. Rather, given that markets are always imperfect, the relevant question is what legal arrangements are necessary to incentivize the erosion of monopoly power by incentivizing entrepreneurs to discover and realize profit opportunities by competing against potential monopolists? The enforcement of efficiency in terms of consumer welfare implies policymakers will know the market structure and price that will equate with marginal costs, consistent with perfect competition. However, from a law-and-economics standpoint, limited liability is a legal rule that only gives rise to the contractual form of corporations, but also serve as *anti-monopoly legal arrangement from which consumer welfare emerges as a by-product*, rather than consumer welfare being a deliberate outcome of regulation based on an ex-ante efficiency criterion.

Khan provides two interrelated arguments in favor of regulation of digital platform economies. The first is based on the notion of market imperfections due to barriers to entry, associated with capital ownership and economies of scale, which in turn create the conditions for monopoly power. The second is on the basis of monopoly power derived from network effects. As Khan argues, “the practical barriers to successful and sustained entry as an online platform are very high, given the huge first-mover advantages stemming from data collection and network effects.”³⁴ The implication here is that monopoly power is secured by the necessity for new firms to incur high fixed start-up costs in order to take advantage of the economies of scale due to the network effects provided by a platform. On this basis, Khan offers two options by which govern platform economies through regulation.

The first option would be to utilize anti-trust policy to enforce a more “competitive” market structure. While the argument that capital requirements constitute a barrier to entry is strengthened by the existence of scale economies, since these will increase the amount of capital needed to compete effectively, the argument does not depend on the superficial identification of large size with monopoly power. This is because entrepreneurial profits are not discovered by virtue of the fact that firm owners are owners of capital.³⁵ Indeed, capital is required to later realize an entrepreneurial opportunity to enter a market, but the ownership of capital is a *consequence* of having first discovered that a profit opportunity exists, and therefore concentration of capital ownership does not necessarily constitute a barrier to entry that would

³³ Rosalino Candela, *Are Markets Imperfect? Of Course, But That's The Point!*, ECONLOG: THE LIBRARY OF ECONOMICS AND LIBERTY (May 18, 2020), <https://www.econlib.org/are-markets-imperfect-of-course-but-thats-the-point/>.

³⁴ Lina Khan, *Amazon's Antitrust Paradox*, 126 YALE L.J. 710, 772 (2017).

³⁵ Israel M. Kirzner, *Perception, Opportunity, and Profit: Studies in the Theory of Entrepreneurship* 94 (1979).

cause monopoly profits.³⁶ The conceptual distinction between entrepreneurship and capital ownership is particularly important, for it leads to an important question regarding the relationship between law and monopoly power: what role does limited liability play in reinforcing or eroding the conditions for corporate power, particularly with respect to digital platforms? The role of limited liability, which may be regarded as the source of corporate power, is also the very basis for its *discipline and erosion*. This is because “limited liability considerably reduces the cost of exchanging shares by making it unnecessary for a purchaser of shares to examine in great detail the liabilities of the corporation and the assets of other shareholders.”³⁷ Otherwise, “any extension of liability beyond the assets of the firm to the personal (extra-firm) assets of the shareholders must, in order to be enforceable, impair transferability of shares.”³⁸ Although limited liability facilitates a distinction between ownership and control of the firm, this should not be regarded as a source of market power. Rather, limited liability becomes the source of market discipline of corporate management, since it facilitates the ability of shareholders to buy and sell ownership shares on the stock market, deflecting corporate management from indulging preferences inconsistent with maximizing profit.³⁹

In effect, limited liability allows potential entrepreneurs, who would otherwise be constrained by ownership limitations, to reduce the transaction costs of raising capital as a by-product of their entrepreneurial insight, allowing markets to take advantage of the dispersed and tacit knowledge of potential competitors, eroding the potential of corporate power. As Israel Kirzner states this point, “where the corporate form of business organization permits a measure of independence and discretion to corporate managers, this is an ingenious, unplanned device that eases the access of entrepreneurial talent to sources of large-scale financing. Instead of the entrepreneur having to borrow capital—with all of the transaction costs we have seen this to involve—the corporate form of organization permits would-be entrepreneurs to hire themselves out to owners of capital as corporate executives. The capitalists retain formal ownership, permitting them, if they choose, to divest themselves easily of their shares in badly managed firms or, in the last resort, to oust incompetent management.”⁴⁰

To avoid undermining the benefits from network effects, another regulatory option would be “to accept dominant online platforms as natural

³⁶ Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 260-62 (1967).

³⁷ Harold Demsetz, *Toward a Theory of Property Rights*, 57 THE AM. ECON. REV. 347, 359 (1967).

³⁸ Susan E. Woodward, *Limited Liability in the Theory of the Firm*, 141 J. INST. & THEORETICAL ECON. 601, 601 (1985).

³⁹ See Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112 (1965); Harold Demsetz, *The Structure of Ownership and the Theory of the Firm*, 26 J.L. & ECON. 375, 387 (1983).

⁴⁰ ISRAEL M. KIRZNER, PERCEPTION, OPPORTUNITY, & PROFIT: STUDIES IN THE THEORY OF ENTREPRENEURSHIP 104 (1979); see also Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 260-63 (1967).

monopolies or oligopolies, seeking to regulate their power instead.”⁴¹ If platform economies are treated as utilities from a regulatory standpoint, as Khan suggests, limited liability also offers a law-and-economics solution to the problem of monopoly power once we distinguish between *competition in the market* and *competition for the market*.⁴² As Demsetz argued in his seminal article on natural monopoly, “Why Regulate Utilities?”, even in the case in which one firm defines a market as a natural monopoly *in production*, due to economies of scale or the realization of network effects, the existence of a natural monopoly *within* that market does not necessarily imply that there cannot be competition among potential bidders to acquire ownership *for* this market once limited liability is taken into account.⁴³

Rather than disregard the interrelationship between markets and politics through legal arrangements, law and economics emerged as a subset of political economy in the second half of the twentieth century. The surest way to create a concentration of economic and political power is to turn the law from an “instrument of production” into a tool for granting special privileges.⁴⁴ If the legal framework governing competition is analogous to factors of production, like land, labor, and capital, what we all wish to avoid is turning a legal framework of rules (shared and enforced impartially across all competitors) into a framework of discretion for the sake of expediency to combat what appears to be threats to open competition. If rules are abandoned for discretion, then the law will become a scarce factor of production, and as is the case with any scarce resource, competition will result; however, such competition will manifest itself in politics rather than markets, taking the form of rent-seeking and regulatory capture. This illustrates the critical lynchpin of law as the intersection between markets and politics. Unfortunately, by failing to disentangle the economic analysis of law from law and economics, it also fails to recognize the emergence of the law-and-economics tradition as part of the Virginia School of Political Economy.

III. LAW AND POLITICAL ECONOMY *BEFORE* THE LPE MOVEMENT

At the core of what the LPE Project takes to be the reconstruction away from the “Twentieth-Century Synthesis” is “a renewed commitment to

⁴¹ Lina Khan, *Amazon’s Antitrust Paradox*, 126 YALE L.J. 710, 797 (2017).

⁴² This distinction developed in Demsetz’s seminal article, “Why Regulate Utilities” (1968), derives from an earlier statement of this distinction by Edwin Chadwick (1859) between “competition for the field” and “competition within the field.” For more on Chadwick’s scholarship, see ROBERT B. EKELUND JR. & EDWARD O. PRICE III, *THE ECONOMICS OF EDWIN CHADWICK: INCENTIVES MATTER* 54 (2012).

⁴³ Harold Demsetz, *Why Regulate Utilities?*, 11 J.L. & ECON. 55, 57 (1968).

⁴⁴ F.A. HAYEK, *THE ROAD TO SERFDOM* 81 (1944); Peter J. Boettke & Rosolino Candela, *Hayek, Leoni, and Law as the Fifth Factor of Production*, 42 ATL. ECON. J. 123, 127 (2014).

questions of political economy.”⁴⁵ By political economy, they do not refer to the economic “analysis of institutions and politics as practiced in mainstream economics departments, which turns on the application of rational-choice models to government actors or institutions” but an “older and more foundational usage familiar to nineteenth-century audiences.” The political economy to which they are referring “investigates the relation of politics to the economy, understanding that the economy is always already political in both its origins and its consequences.”⁴⁶ This definition of political economy relates back to the classical economists, and the distinction they are drawing overlaps quite strongly with the origins of Virginia Political Economy, which is distinct from public choice understood simply as the economics of political decision-making.

A. *Virginia Political Economy: Complement or Substitute to Law and Political Economy?*

The institutional origins of Virginia Political Economy can be traced back to the Thomas Jefferson Center for Studies in Political Economy and Social Philosophy at the University of Virginia (UVA), of which Ronald Coase was a member alongside James Buchanan and G. Warren Nutter, who were its co-founders.⁴⁷ The historical origins of Virginia Political Economy reveal a shared *analytical* point of departure with the LPE project, which sought to reclaim an understanding of political economy within intellectual environment that had, by the mid-20th century, purged economics of its legal, political, and social embeddedness.

By the mid-20th century, the tacit presupposition of economists regarding the government’s role in a market economy had shifted from a “laissez-faire presumption” to a “market failure presumption.”⁴⁸ Although this change in presumption could be understood as ideological, this interpretation redirects attention away from its *historical* as well as *methodological* origins. Reframing the context in this way illustrates the shared analytical starting points of Virginia Political Economy and the LPE movement. The rise of a “market failure” presumption can be attributed to the fact that 19th century liberalism had become identified in the political imagination with extreme *laissez faire*, which seemed unable to address the realities of monopoly power, the inherent instability caused by the speculative behavior of financial

⁴⁵ Jedediah S. Purdy, David Singh Grewal, Amy Kapczynski, and K. Sabeel Rahman, *Building a Law-and-Political Economy Framework: Beyond the Twentieth-Century Synthesis*, 129 YALE L.J. 1785, 1792 (2020).

⁴⁶ *Id.*

⁴⁷ See DAVID M. LEVY & SANDRA J. PEART, TOWARDS AN ECONOMICS OF NATURAL EQUALS: A DOCUMENTARY HISTORY OF THE EARLY VIRGINIA SCHOOL 41-42 (2020).

⁴⁸ PETER J. BOETTKE & PETER T. LEESEON, THE ECONOMIC ROLE OF THE STATE xiii-xviii (2015).

capital, and of the inequalities and injustices that resulted from concentrations of wealth.

Although early neoclassical economists had a common understanding of the proper institutional context undergirding a liberal market order, the marginal revolution initiated a tendency that relegated such an understanding to the background of analysis. What emerged in the foreground was a growing emphasis on analyzing markets as equilibrium states rather than processes. As a result, the institutions that frame a liberal market order had been taken for granted, so much so that their role in the providing the rules governing a market economy, which critics of liberalism claimed to be lacking, had become relatively neglected, leading to the notion that markets operated in an institutional vacuum. The liberals, though, in their effort to respond to this earlier intellectual weakness were moved to justify government intervention on *methodological grounds*, due to the fact that their understanding of the invisible hand process was one that must conform to an ideal outcome consistent with perfect competition, manifesting in what Francis Bator coined as “market failure.”⁴⁹ The association of liberalism with laissez-faire, therefore, required a rearticulation and restatement of the role that institutions play in the operation of a liberal market order.⁵⁰ Understood against this historical backdrop, economics supplanted political economy.⁵¹

While the presumption of “market-failure” can best be understood as methodological, its solution is better understood as *epistemological*, rather than political or ideological. Under the laissez-faire presumption, the analytical description of the market economy was complemented by a default presumption to limit government’s role in the marketplace, generally speaking, to the protection of private property and contract enforcement under the rule of law. However, under the market failure presumption, economists assume that the presence of macroeconomic instability, monopoly power, externalities, and public goods will necessitate government correction of the market’s allocative process. The distinction here is not simply a presumption of “more government” or “less government,” but fundamentally a presumption of what knowledge government officials possess to correct market failures. Buchanan best states this distinction as follows:

The classical (Smithean) argument for control (or depoliticization) and the welfare economists’ argument for control (for politicization) are on all fours *only if we presume the existence of the same underlying evaluative standard in the two cases*. To suggest, with the welfare economists, that market failure supports politicization, there must be not only departures from the necessary conditions for efficiency, but also some presumption that political action is informed by a knowledge of what the allocatively efficient solution is, quite apart from the operation of politics itself. By contrast, to suggest, with Adam Smith, that regulatory failure supports market liberalization does not require any presumptive knowledge about what particular outcome is likely to produce maximal value. *There is a categorical epistemological difference between*

⁴⁹ Francis Bator, *The Anatomy of Market Failure*, 72 Q. J. ECON. 351, 351 (1958).

⁵⁰ See Boettke and Candela, *supra* note 45, at 123.

⁵¹ JOSEPH FISHKIN & WILLIAM E. FORTBATH, *THE ANTI-OLIGARCHY CONSTITUTION: RECONSTRUCTING THE ECONOMIC FOUNDATIONS OF AMERICAN DEMOCRACY* 364-69 (2022).

*the two comparative exercises, a difference that many modern economists still do not understand.*⁵²

The conventional wisdom is that the rise of public choice theory provided a “government failure” counterargument to the presumption that government intervention could serve as a corrective to market failure. While this is not incorrect, it would justify, as LPE scholars would conclude, “a growing public-law skepticism toward political judgments about distribution and economic ordering, based on the conviction that these judgments are likely to enforce and entrench the kinds of ‘capture’ that James Buchanan’s ‘political economy’ emphasized.”⁵³ Thus, scholars of the LPE project would conclude public choice theory takes “the form of a *market tragedy*” in the sense that, out of skepticism with government failure, the persistence of market failures is seen as “efficient,” thereby justifying the status quo in politics and markets.⁵⁴ Unbeknownst to scholars of the LPE project, who reject this notion of market and political processes, this is *precisely the opposite* of how Buchanan and Virginia Political Economy envisions political economy. Consider the following statement by Buchanan:

A market is not competitive by assumption or by construction. A market *becomes* competitive, and competitive rules *come to be* established as institutions emerge to place limits on individual behavior patterns. It is this *becoming* process, brought about by the continuous pressure of human behavior in exchange, that is the central part of our discipline, if we have one, not the dry-rot of postulated perfection. A solution to a general-equilibrium set of equations is not predetermined by exogenously-determined rules. A general solution, if there is one, *emerges* as a result of a whole network of evolving exchanges, bargains, trades, side payments, agreements, contracts which, finally at some point, ceases to renew itself. At each stage in this evolution towards solution, there are *gains* to be made, there are exchanges possible, and this being true, the direction of movement is modified.⁵⁵

Unlike in a constrained maximization problem defined by exogenously fixed constraints, public choice theorists of the Virginia School make an analytical distinction between choice within a set of rules and choice over a set of rules. Virginia public choice theorists direct analytic attention to *choice over constraints* to highlight that political outcomes are an outcome of a mutually beneficial agreement. It is at this point that the “constitutional level” of analysis that individuals strive to agree to mutually beneficial rules that constrain their behavior in a manner that yields Pareto-optimality as a *by-product*, not as beginning assumption of analysis.

The importance of this analytical distinction for the LPE project can be understood in terms of the following quote from Frank Knight: “to call a situation hopeless is for practical purposes the same thing as calling it

⁵² JAMES M. BUCHANAN, “*Adam Smith as Inspiration*” in THE COLLECTED WORKS OF JAMES M. BUCHANAN 292 (2001) (emphasis added).

⁵³ Purdy, Grewal, Kapczynski, and Rahman, *supra* note 46, at 1799.

⁵⁴ *Id.* at 1801 (emphasis added).

⁵⁵ James M. Buchanan, *What Should Economists Do?*, 30 SOUTH. ECON. J. 213, 218 (1964).

ideal.”⁵⁶ For both scholars of the LPE project and the Virginia Political Economy tradition, the fact that our status quo is a non-ideal world, or “imperfect” in the meaning I suggested above, is one that builds hope into the center of political economy. The source of that hope rests on *discovering* a better “game,” not by finding “better” players, but changing the rules in order to generate better outcomes. The notion that rent-seeking activity and regulatory capture justifies political inaction in the marketplaces, and therefore questions of distributive justice, equality, and economic power, has been ignored in political economy, and according to LPE scholars, requires a clarification of Virginia Political Economy on three interrelated grounds.

First, scholars of the LPE project conflate associate a positive argument for constitutional *rules* with a normative argument for constitutional *inaction*. The fact that positive economic analysis implies that political discretion incentivizes rent-seeking does not imply a normative argument against state inaction against special privileges that concentrate economic power and wealth. Rather, it provides a normative basis for changes in rules that reduce political discretion, which in turn reduces the returns to seeking special privileges in the first place. Fishkin and Forbath in *The Anti-Oligarchy Constitution* state that because “it blends the normative with the analytical and the economic with the political, political economy always has lent itself to constitutional discussion.”⁵⁷ Therefore, to the extent that the LPE project is motivated to reconstruct political economy in a manner that is not insulated from questions pertaining to distributive justice, equality, economic power, etc., its normative concerns can be mapped onto a Virginia Political Economy framework. As Buchanan states, Virginia Political Economy “has advanced our scientific understanding of social interaction, but the science has been consistently applied to a normative question.”⁵⁸ The positive and normative distinction has been more appropriately redefined by Viktor Vanberg as a distinction between “*theoretical* and *applied* political economy.”⁵⁹ As he further expands on this distinction:

To be sure, applied sciences have a normative purpose: they aim at using the insights of their theoretical counterpart to find solutions to practical problems. Yet, their normative purpose does not make them ‘normative’ sciences. To be sure, the problem-solving recommendations they propose are *value judgments* in the sense that they say what one *should* do to solve a problem. Yet, the recommendations are conditional rather than *unconditional* should-be-

⁵⁶ Frank H. Knight, *Ethics and Economic Reform I: The Ethics of Liberalism*, 21 *ECONOMICA* 1, 1 (1939).

⁵⁷ JOSEPH FISHKIN & WILLIAM E. FORBATH, *THE ANTI-OLIGARCHY CONSTITUTION: RECONSTRUCTING THE ECONOMIC FOUNDATIONS OF AMERICAN DEMOCRACY* 365 (2022).

⁵⁸ JAMES M. BUCHANAN, *VIRGINIA POLITICAL ECONOMY: SOME PERSONAL REFLECTIONS*, 63 (2001).

⁵⁹ Viktor J. Vanberg, *J.M. Buchanan’s Contractarian Constitutionalism: Political Economy for Democratic Society*, 183 *PUBLIC CHOICE* 339, 343 (2020).

statements—they are, in philosophical parlance, *hypothetical* rather than *categorical* imperatives. They say what one should do *if* one wants to solve the problem in question.⁶⁰

Therefore, when LPE scholars suggest that there is a “problem,” the Virginia political economist suggests *if* your objective is to mitigate this problem, *then* we must first understand the rules that generated the incentives, knowledge, and actions that resulted in this problem in the first place.

Vanberg’s assessment has two implications for the LPE Project. First, nothing about an appeal to choice over rules implies a categorical imperative that suggest rules should maximize “efficiency.” Rather, efficiency is an outcome discovered in the process of its emergence within rules, and therefore no policymaker can prescribe that outcome outside of that context in which those rules are in place. Secondly, when “market failures” occur, it implies an incomplete market or a failure to establish the institutional preconditions for a market, without which “the true dimensions of normative ‘failure’ cannot be entirely known” since the outcome consistent with efficiency does not exist outside of that context.⁶¹ For example, anyone attempting to mitigate a market failure associated with a negative externality (such as a policymaker assigning a tax, or a judge reassigning property rights) for the purpose of internalizing a social cost into a transaction presumes knowledge of what the perfectly competitive outcome would be in that context *before* that outcome has resulted.⁶² We will return to this point in Section III.2. as it directly relates to the field of law and economics as an offshoot of Virginia Political Economy.

Second, relevant political choices are not about directly choosing alternative distributions of income or allocations of resources as a deliberate outcome, but rather about choices over rules from which distributions of income or allocations of resources emerge as result of social interaction within those roles. The nature of rules is that equality before the law in “an *expected* sense emerges only because of an intrinsic unpredictability of the future pattern political coalitions,” preventing the concentration of economic power with political power.⁶³ A generality norm operates as a “meta-legal doctrine,” through which the types of laws that are filtered through the legislative process are those that are *end-independent* and *impersonal*.⁶⁴ Laws that are consistent with the rule of law must neither command any specific purpose upon individuals nor assign any concrete status or outcome that differentiates individuals before the law. This does not mean that laws that recognize

⁶⁰ Viktor J. Vanberg, *J.M. Buchanan’s Contractarian Constitutionalism: Political Economy for Democratic Society*, 183 *PUBLIC CHOICE* 339, 343 (2020).

⁶¹ Geoffrey Brennan & James M. Buchanan, *The Collected Works of James M. Buchanan, Volume 10: The Reason of Rules: Constitutional Political Economy*, *LIBERTY FUND* 1, 18 (1985).

⁶² Mario J. Rizzo, *Law amid Flux: The Economics of Negligence and Strict Liability in Tort*, *J. LEGAL. STUD.* 291, 299 (1980).

⁶³ Geoffrey Brennan & James M. Buchanan, *The Collected Works of James M. Buchanan, Volume 10: The Reason of Rules: Constitutional Political Economy*, *LIBERTY FUND* 1, 143, 148 (1985).

⁶⁴ HAYEK 206 (1960).

individuals based on sex, race, or creed violate the rule of law; rather, it is only when such groups are preassigned a special status or privilege at the expense of other individuals that the rule of law is violated. This violation occurs in a twofold manner. From a static standpoint, resources and income are transferred by force to the politically privileged to the expense of the politically disenfranchised. From a dynamic standpoint, the political transfer from one party to another cannot occur without simultaneously granting discretion to the political official, who must exercise arbitrary force in making such a transfer. When the rule of law is violated, the legislator is no longer “blind,” but can in fact foresee how and to whom laws will affect particular groups of individuals in society. The change from rules to discretion has an undesirable distributive consequence, from the standpoint of the LPE movement, indirectly from its impact on the law, which degenerates from an instrument of production into a tool for granting special privileges. Although scholars of the LPE project would conclude that “market ordering is only neutral if one takes power off the table,” they challenge the myth of the state neutrality in classical liberal thought.⁶⁵ “Through its elevation of wealth as an orienting public value, it has reinforced a very nonneutral drift toward elite control of government, increasingly described by political scientists as ‘oligarchy.’”⁶⁶

This brings us to the third, and perhaps most misunderstood, aspect of Virginia Political Economy but most relevant for Law and Political Economy: the relevance of the status quo in political and economic theorizing. According to Buchanan, “the political economist is concerned with discovering ‘what people want.’ The content of his efforts may be reduced to very simple terms. This may be summed up in the familiar statement: *There exist mutual gains from trade.*”⁶⁷ “His task is that of locating possible flaws in the existing social structure and in presenting possible ‘improvements.’”⁶⁸ However, the discovery of mutual gains trade through changes in rules must begin by acknowledging the prevailing status quo. Whereas the “Twentieth-Century Synthesis,” according to the LPE project, would suggest that the status quo is a normative ideal for conservative purposes, for Buchanan, the status quo serves an analytical starting point for Pareto-improving reform through institutional changes. Buchanan attributes no normative weight to the status quo, just as scholars of the LPE project would not. Rather, “[a]ny proposal for change involves the status quo as the necessary starting point. ‘We start from here,’ and not from someplace else.”⁶⁹ By taking the status quo as an analytic

⁶⁵ Jedediah S. Purdy et al., *Building a Law-and-Political Economy Framework: Beyond the Twentieth-Century Synthesis*, 129 YALE L.J. 1784, 1784 (2020).

⁶⁶ *Id.* at 1783-1784.

⁶⁷ James M. Buchanan, *Positive Economics, Welfare Economics, and Political Economy*, 2 J. L. ECON. 124, 137 (1959).

⁶⁸ *Id.*

⁶⁹ JAMES M. BUCHANAN, *THE LIMITS OF LIBERTY: BETWEEN ANARCHY AND LEVIATHAN* 78 (1975).

starting point, we next evaluate how Virginia Law and Economics emerged as an outgrowth of Virginia Political Economy, and how both share much more in common with the LPE project in their criticisms of the economic analysis of law.

B. *Toward a Virginia School of Law and Economics*

What scholars of the LPE movement and Virginia Law and Economics also have in common is that they regard *The Calculus of Consent* as a one of the foundational works of law and economics.⁷⁰ According to Henry Manne, public choice in the Virginia tradition is “an essential ingredient of serious law and economics scholarship”⁷¹ that had been opened up by *The Calculus of Consent*.

Before explaining the interconnection between law and political economy in the Virginia School, and why has the LPE project has overlooked this connection, we must first identify why law and economics can be traced back to the University of Virginia, rather than the University of Chicago, in the first place. According to Manne’s account, the development of law and economics can be traced back to the oral tradition of Aaron Director, who was also the founding editor of *The Journal of Law and Economics*. Ronald Coase would later succeed Director in 1964, when he first joined the faculty of the University of Chicago Law School and would then become editor of *The Journal of Law and Economics*. It is not uncommon, therefore, for Ronald Coase to be identified as a “Chicago School” Economist. For several other reasons, this would not be an unfair characterization. As a student at the London School of Economics, Coase, like other economists of the Chicago School, had been greatly influenced by the work of Frank Knight, particularly *Risk, Uncertainty, and Profit*.⁷² Although Coase had regarded himself as a socialist in his youth, his training at the LSE under Arnold Plant and his study of the workings of the operation of markets in public utilities, postal services, and lighthouses solidified his free-market convictions, as is often identified with Chicago School economists, such as Milton Friedman, George Stigler, or Gary Becker. Moreover, the tendency for government regulation to serve special interests, rather than the public interest, also affirmed his skepticism of government intervention. It would seem, then, that Coase carried all the trappings of a Chicago economist.

However, as economist Steve Medema has argued, the “relationship between Coase and the Chicago School could be considered a case study in the

⁷⁰ Jedediah S. Purdy et al., *Building a Law-and-Political Economy Framework: Beyond the Twentieth-Century Synthesis*, 129 YALE L.J. 1784, 1811 (2020).

⁷¹ ROBERT MANNE, *LEFT RIGHT LEFT: POLITICAL ESSAYS 1977-2005* 293 (2005); Alan S. MANNE, *STUDIES IN PROCESS ANALYSIS* 147 (1963).

⁷² FRANK H. KNIGHT, *RISK, UNCERTAINTY, AND PROFIT* (Houghton Mifflin ed., 1921).

dangers of assuming some sort of Chicago homogeneity.”⁷³ Indeed, Coase shared similar public policy conclusions as his contemporaries at Chicago. But to identify an economist by his or her free-market policy conclusions, instead of the *methodology* by which they arrive at such conclusions, renders indistinguishable the distinction between the Chicago School and the Austrian School, or between Chicago and its intellectual cousins at the University of California, Los Angeles (UCLA), the University of Washington, or the University of Virginia (UVA) for that matter.

In terms of methodology, Coase would be better identified as an economist of the Virginia School. Though Buchanan, Tullock, and other faculty members, such as Rutledge Vining and G. Warren Nutter, had been trained at the University of Chicago, what distinction, if any, exists between the Virginia Law and Economics, as opposed to way in which law and economics evolved at the University of Chicago? Moreover, why is attributing the label “Virginia School” to Coase even important? Though Coase’s own work shares many policy conclusions with that of public choice theorists, particularly skepticism of government intervention to mitigate supposed market failures, the relationship between Coase and Public Choice introduces another danger of homogeneity, since other branches of Public Choice have emerged as well, besides that which emerged at UVA (and later Virginia Tech and George Mason University). These include the “Bloomington School” of Vincent and Elinor Ostrom and the “Rochester School” of William Riker. Moreover, Public Choice was also developed by economists at the University of Chicago, including Gary Becker, Sam Peltzman, and George Stigler.⁷⁴

As Todd Zywicki has highlighted,⁷⁵ the Virginia School of Law and Economics emerged from the marriage of subjective cost theory that had been developed at the London School of Economics (LSE) under F.A. Hayek and Lionel Robbins, and price theory from the University of Chicago. The work of Frank Knight had been a cornerstone of the education of students at the University of Chicago and the LSE alike in the pre-WWII era, and Knight had been highly influential in Coase’s education. But whereas price theory at Chicago had been primarily Marshallian, in which costs are taken to be objective, price theory at the LSE had been primarily Wicksteedian, *in which supply curves are simply the demand curve of suppliers*, and therefore part of the total demand curve for a good or service, the value of which is subjective. In his own recollection of the LSE of the 1930s, Coase remarks that, unlike at Chicago, at the LSE, “Marshall was in the calendar of saints but few of us prayed exclusively to him. Marshall was one among many economists

⁷³ STEVEN G. MEDEMA, *THE HISTORY OF ECONOMIC THOUGHT* 262 (2010).

⁷⁴ See generally, WILLIAM MITCHELL, *VIRGINIA, ROCHESTER, AND BLOOMINGTON: TWENTY-FIVE YEARS OF PUBLIC CHOICE AND POLITICAL SCIENCE* (1988); DENNIS C. MUELLER, *PUBLIC CHOICE III* (1976).

⁷⁵ Todd J. Zywicki, *Keynote Address: Is There A George Mason School of Law and Economics*, 10 J. L. ECON. POL’Y 543, 548 (2014).

studied”, and goes further to state that, “[i]n fact, we thought his views on cost confused” rather than clarified the analysis of market processes.⁷⁶

Therefore, what Coase shared with Buchanan and other economists of the Virginia School, which made them distinct from their intellectual cousins at Chicago,⁷⁷ is the fact that they saw opportunity costs not as constraints to which economic actors passively respond, but as variables defined by the act of choice itself. Because of this, Virginia School political economists, such as Coase, directed their analytic attention to *choice among constraints*, and thus saw institutions, organizations, and other contractual arrangements as a by-product of individuals striving to realize the gains from exchange. Virginia Law and Economics, therefore, took a *constitutional perspective*, which focuses on analyzing “the rules of game” and how the modification of institutions could generate positive-sum forms of interaction. Therefore, whereas their contemporaries of the post-WWII Chicago School took Pareto-optimality as an *assumption* that characterizes real-world market outcomes, Coase and the Virginia School understood the conditions of Pareto-optimality to be a *by-product* of individuals devising institutional arrangements, not only to reduce transaction costs, but also to exhaust the gains from trade.

This distinction between a Coasean approach law and economics, and a Posnerian approach to the economic analysis of law, is best highlighted not only by how economists at the University of Chicago first reacted to what later became known as the “Coase Theorem,” and also how the Coase Theorem is still interpreted today, but also Buchanan’s reactions to Richard Posner’s *Economic Analysis of Law. “The Problem of Social Cost”*⁷⁸ had been written in response to what Friedman, Stigler, Harberger, and other economists at the University of Chicago had perceived as a fundamental error in Coase’s analysis of Pigovian welfare economics, as had been first argued in the “The Federal Communications Commission.”⁷⁹ However, what needs constant reminding is not only that both of these papers were written when Coase was a faculty member at UVA, but also that, at UVA, his ideas were regarded as an evolution of the common knowledge that he, Buchanan, Nutter, and Vining had inherited from Frank Knight. Surprisingly, as George Stigler recounts in his autobiography, it was among Knight’s former pupils, including Friedman and himself, at the University of Chicago that Coase’s ideas were considered a revolution that overturned Pigouvian welfare economics.⁸⁰ As George Stigler recounts in the third edition of *The Theory of Price*, where he first defines the Coase Theorem, notes that the Coase

⁷⁶ Ronald H. Coase, *Economics at LSE in the 1930s: A Personal View*, 10 ATLANTIC ECON. J. 31, 34 (1982).

⁷⁷ Richard E. Wagner, *Chicago Political Economy, and Its Virginia Cousin* 1–35 (GMU Working Paper in Econ., Working Paper No. 20–11, 2020).

⁷⁸ See generally, Ronald H. Coase, *The Problem of Social Cost*, 3 THE JOURNAL OF LAW AND ECONOMICS 1, (1960).

⁷⁹ See generally, Ronald H. Coase, *The Federal Communications Commission*, 2 THE JOURNAL OF LAW AND ECONOMICS 1, (1959).

⁸⁰ GEORGE J. STIGLER, MEMOIRS OF AN UNREGULATED ECONOMIST 75 (1988).

Theorem “is a more remarkable proposition to us older economists who have believed the opposite for a generation, than it will appear to the young reader who was never wrong, here.”⁸¹

“Law and economics,” as suggested by LPE scholars, “centered the identification and elimination of transaction costs, channeling the Paretian utopia of Ronald Coase’s famous frictionless plane of exchange—a kind of heaven, not of legal concepts... but of general equilibrium.”⁸² However, this interpretation is far more akin to that of Stigler, who states that the Coase Theorem “asserts that *under perfect competition* private and social costs will be equal.”⁸³ Though the Coase Theorem has become a cornerstone of law and economics and institutional economics generally, Coase’s central message cannot be fully understood unless we first realize how he understands the nature of costs. As he recounted repeatedly, the Coase Theorem was never meant to direct our attention to a world in which transaction costs are zero. In such a world, markets will have already exhausted all the gains from trade, and institutions are therefore redundant. Rather, what Coase was trying to stress is *how positive transaction costs represent future profit opportunities for their reduction, and how individuals realize gains from trade by perceiving a way to reduce transaction costs via institutional arrangements*. As Coase has highlighted throughout his work, from his seminal paper “The Nature of the Firm,”⁸⁴ to his last book, *How China Became Capitalist*,⁸⁵ the benefit of institutional and organizational arrangements, such as contracts, firms, money and property rights, are that they reduce the costs of making an exchange (i.e. transaction costs). Costs are not a constraint independent of human choice, but are an artifact of human choice, and therefore can be manipulated by restructuring the payoff structure embodied in institutions through human creativity. As Coase states, “a large part of what we think of as economic activity is designed to accomplish what high transaction costs would otherwise prevent or to reduce transaction costs *so that individuals can freely negotiate and we can take advantage of that diffused knowledge of which Hayek has told us*.”⁸⁶

This raises another important aspect of Virginia law and economics, and why the LPE project’s characterization of law and economics has not only been misdirected, but also presents a missed opportunity to develop a positive research agenda. The distinctness of Virginia law and economics “is

⁸¹ GEORGE J. STIGLER, *THE THEORY OF PRICE* 113 (1966).

⁸² Jedidiah Britton-Purdy et. al., *Building a law and political economy framework: Beyond the twentieth century synthesis*, YALE L.J. 1785, 1805-06 (2020).

⁸³ *Supra* note 80 (emphasis added).

⁸⁴ *See generally*, Ronald H. Coase, *The Nature of the Firm*, 4 *ECONOMICA*, NEW SERIES (1937).

⁸⁵ *See generally*, RONALD H. COASE & NING WANG, *HOW CHINA BECAME CAPITALIST* (2012).

⁸⁶ Ronald H. Coase, *The Institutional Structure of Production*, *THE AMERICAN ECONOMIC REVIEW*, 713, 716 (1992) (emphasis added).

basically bringing Hayek and information discovery into law and economics.”⁸⁷ “Law and economics,” according to scholars of the LPE project, “was inevitably itself a form of planning” for the sake of efficiency.⁸⁸ Notwithstanding their conflation between law and economics and the economic analysis of law, criticism of the economic analysis of law is also reflected in Buchanan as well as Tullock’s review of Posner’s *Economic Analysis of Law*. “Good economics, Chicago-style, which is what Posner teaches, is better than no economics,”⁸⁹ but as Buchanan and Tullock⁹⁰ highlight, Posner conflates the distinction between law and legislation as highlighted by Bruno Leoni⁹¹ and F.A. Hayek.⁹²

The distinction between law and legislation can be understood in terms of the purpose of each. Following the Hayekian notion of law as part of a spontaneous order, Leoni⁹³ defines law as a set of *individual claims* “that have a good probability of being satisfied by corresponding people in a given society at any given time, the reasons why they may be satisfied in each single case being variable and based alternatively or jointly on moral or technical rules.”⁹⁴ Therefore, the nature of law is that it is *purpose-independent* or must be applicable and impartial to further instances of unforeseen conflicts of interest, each of which varies in particular circumstances. The purpose of law, as opposed to legislation, is not to achieve a particular aim to achieve a foreseen outcome that results in favoring one party over another. Law, like the price mechanism, communicates subjectively-held expectations between individuals that emerge through contestation, and are made publicly available through dispute resolution of competing claims, as historically evidenced in medieval Europe by Benson⁹⁵ as well as Stringham and Zywicki⁹⁶. Hayek further states:

In the ordinary sense of purpose the law is therefore not a means to any purpose, but merely a condition for the successful pursuit of most purposes. Of all multipurpose instruments it is probably the one after language which assists the greatest variety of human purposes. It

⁸⁷ Todd Zywicki, Professor, George Mason University Foundation Professor of Law, George Mason University, Antonin Scalia Law School, KEYNOTE ADDRESS: IS THERE A GEORGE MASON SCHOOL OF LAW AND ECONOMICS? 546 (2013).

⁸⁸ *Supra* note 81 at 1799.

⁸⁹ James M. Buchanan, Good Economics. Bad Law, 60 VIRGINIA LAW REVIEW, 483, 484 (1974)

⁹⁰ GORDON TOLLUCK, THE ECONOMICS OF WAR AND REVOLUTION (1974).

⁹¹ *See generally*, BRUNO LEONI, FREEDOM AND THE LAW (1961).

⁹² *See generally*, FREDERICH A. HAYEK, LAW, LEGISLATION AND LIBERTY : A NEW STATEMENT OF THE LIBERAL PRINCIPLES OF JUSTICE AND POLITICAL ECONOMY (1973).

⁹⁴ BRUNO LEONI, FREEDOM AND THE LAW 197 (1991).

⁹⁵ Bruce L. Benson, *The Spontaneous Evolution of Commercial Law*, S. ECON. J. 644, 645-646 (1989).

⁹⁶ Edward Peter Stringham & Todd J. Zywicki, *Rivalry and Superior Dispatch: An Analysis of Competing Courts in Medieval and Early Modern England*, PUBLIC CHOICE 497, 517 (2011).

certainly has not been made for any one purpose but rather has developed because it made people who operated under it more effective in the pursuit of their purposes.⁹⁷

Thus, the role of law is to *coordinate the discovery* of expectations over time, between individuals about their particular claims, rather than to *dictate* to individuals what those expectations should be about their particular claims.

If, as Coase's critique of Pigovian welfare economics suggests, once transaction costs are positive, public actors, just like private actors, will not know, absent the process of negotiation and discovery between parties to a dispute, how to pick the optimal tax or subsidy scheme to align private costs with social costs, or private benefits with social benefits, respectively, then it also implies that judges cannot deliberately legislate following a particular social objective, namely efficiency.⁹⁸ This is because, if "rules are viewed as providing information to enable the players to predict each other's decisions, it follows that any change in the rules *destroys* information" that would have emerged in that context.⁹⁹ Therefore, as Rizzo states, "the absence of a unique objective measure of social cost all conspire to make the efficiency paradigm a delusion, the importance of certainty in the legal order is clear."¹⁰⁰ Reinforcing this point in a letter of praise to Rizzo on an earlier draft of his paper, Buchanan further elaborates on the distinction between legislation and law, respectively, as:

"the distinction between the choice of criteria for deciding particular cases and the choice of criteria for deciding what the law is to be, applied over all cases subsequently. Much of the law-economics discussion of cases seems to me to confuse this distinction, presumably because judges consider themselves to be deciding what the law is to be, rather than enforcing or *finding the law that is*."¹⁰¹

Buchanan's final point in his critique of Posner also applies directly to a law and political economy framework, in which "laws are the output of political order, making the law the essential connective tissue between political judgment and economic order."¹⁰² This interconnected structure implies a conceptual distinction between (1) a "protective state" at a constitutional

⁹⁷ F. A. Hayek, *Law, Legislation, and Liberty, Volume I: Rules and Order*, THE UNIVERSITY OF CHICAGO PRESS 113 (1973).

⁹⁸ Peter Aranson, *The Common Law as Central Economic Planning*, CONST. POL. ECON. 289, 319 (1992).

⁹⁹ Geoffrey Brennan & James M. Buchanan, *The Collected Works of James M. Buchanan, Volume 10: The Reason of Rules: Constitutional Political Economy*, LIBERTY FUND 1, 13 (1985).

¹⁰⁰ Mario J. Rizzo, *Law amid Flux: The Economics of Negligence and Strict Liability in Tort*, J. LEGAL. STUD. 291, 317 (1980).

¹⁰¹ James M. Buchanan, *Letter to Professor Mario J. Rizzo*, GEORGE MASON UNIVERSITY LIBRARIES (April 9, 1979).

¹⁰² Jedediah S. Purdy et al., *Building a Law-and-Political Economy Framework: Beyond the Twentieth-Century Synthesis*, 129 YALE L.J. 1784, 1792 (2020).

level of analysis that defines the rules of collective decision-making; (2) the institutions of law that emerge to set expectations and adjudicate conflicting claims made within this set of rules; and (3) and “productive state” in which “public goods” and services are provided to the collective benefit of individuals. Whereas (1) and (3) are regarded as the appropriate contexts for legislation, the problem arises when the jurist abandons his rule to facilitate the discovery of law and attempts to intervene at the constitutional or post-constitutional level of decision-making. What the LPE Project fails to recognize from these lessons in Buchanan and the Virginia School is that what severs the essential connective tissue between the political order and the economic order, and unleashes the *predatory state* that the LPE movement wishes to avoid, is the very solution that it claims to be the cure to the social maladies they identify: *political discretion in the law*. In words stated by the LPE Project: “Law is central to how these crises were created and will be central to any reckoning with them. Law conditions race and wealth, social reproduction, and environmental destruction. Law also conditions the political order through which we must respond.”¹⁰³ The tragedy of the LPE Project is that it explains the efficiency, rather than the alleged fragility, of the “Twentieth-Century Synthesis” they so wish to dismantle. To the extent that Posner is identified by *both* Virginia political economists and LPE scholars as adopting an efficiency criterion, and that legislating efficiency has sidelined questions of distribution, power, and democracy, as LPE scholars would claim, then the solutions to ameliorating maldistributions of income, reducing monopoly power, and eliminating political privilege cannot be found simply in a criticism of an economic analysis of law. Rather, to the extent that the LPE project has identified an *institutional* problem that requires an *institutional* solution, the answers can be found in Virginia law and economics, which they ironically reject.

IV. LAW & POLITICAL ECONOMY: A MISSED OPPORTUNITY?

“If it is to succeed,” Purdy, Grewal, Kapczynski, and Rahman state, “law and political economy will also require something beyond mere critique. It will require a positive agenda.”¹⁰⁴ The resulting market failure and government failure that the LPE project attributes to the “Twentieth-Century Synthesis” emerges as a status quo, but only as an artifact of their preoccupation with the economic analysis of law. From a Virginia School standpoint, the very social maladies highlighted by the LPE movement are not caused by any inherent failures of market processes or political processes, but, rather ironically, a *consequence* of LPE scholars failing to embed their account of

¹⁰³ Jedediah Britton-Purdy et al., *Law and Political Economy: Toward a Manifesto*, LPE PROJECT BLOG (Nov. 6, 2017), <https://lpeproject.org/blog/law-and-political-economy-toward-a-manifesto/>.

¹⁰⁴ Jedediah S. Purdy et al., *Building a Law-and-Political Economy Framework: Beyond the Twentieth-Century Synthesis*, 129 YALE L.J. 1784, 1834 (2020).

the “Twentieth-Century Synthesis” within the context of the Virginia School of Political Economy & Law and Economics.

Much like in the period in which Virginia Political Economy and Law and Economics was born, the LPE movement has recentered a market failure presumption in the foreground of analysis. The implications of our argument for Law and Political Economy are twofold in terms of the policy conclusions they wish to draw, which are tragic and represent missed opportunities for LPE scholars. First, to the extent that the LPE project has identified a status quo in markets and politics as being consistent with “market failure” and “government failure,” they have not rejected the efficiency criterion as a normative welfare standard they wish to criticize. Rather, like the “Twentieth Century Synthesis” they identify, they are ironically straight-jacketed by the paradigm within which they operate.

Secondly, by failing to recognize the distinction between a Coasean approach to law and economics and a Posnerian approach to the economic analysis of law, their analysis has not identified a solution to the failures they identify in political and market processes. This does not suggest that they have ignored constitutional political economy altogether, but by conflating libertarianism with the application of an efficiency norm to markets and politics, they have failed to recognize in Virginia Political Economy that the status quo is a “conversation starter” for Pareto-improving rule changes, rather than, as LPE scholars view it, a normative “conversation stopper”¹⁰⁵ that would justify constitutional rules to preserve the purported optimality of the status quo. Indeed, Virginia Political Economy recognizes that market processes and political processes are embedded within a set of institutional arrangements, but the principle of mutually beneficial exchange, not efficiency, is the criterion for collective action in politics as well as private action in markets. Whereas LPE scholars would deny the “purported neutrality in market ordering,”¹⁰⁶ for Virginia political economics, neutrality (or non-discriminatory) state action is not a description or state of affairs. Rather, it is a goal that the institutional design should be set up to design if at all possible. Circumscribing state action is not a justification of the status quo as a normative ideal, but a means by which to move off the status quo and eliminate the non-neutrality of the predatory state that the LPE movement identifies as the source of social maladies they wish to eliminate. Unfortunately, LPE scholars up to this point have been blinded, ironically, by their preoccupation with efficiency as an *ex-ante* assumption of analysis and have failed to see a Virginia Political Economy & Law and Economics as an institutional project that is consistent with the ends they wish to achieve.

¹⁰⁵ Joseph Fishkin & William E. Forbath, *The Anti-Oligarchy Constitution: Reconstructing the Economic Foundations of American Democracy*, HARVARD UNIVERSITY PRESS 1, 29 (2022).

¹⁰⁶ Angela Harris and James J. Varellas, *Introduction: Law and Political Economy in a Time of Accelerating Crises*, J.L. & POL. ECON. 1, 12 (2020).